

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS: 04-0297**  
**Individual Adjusted Gross Income Tax**  
**For the Year 2002**

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**ISSUE**

**I. Ohio Income – Adjusted Gross Income Tax.**

**Authority:** IC 6-3-3-3(a); 45 IAC 3.1-1-74; 45 IAC 3.1-1-76; Ohio Rev. Code Ann. § 5733.40(A)(7).

Taxpayer argues that he is entitled to an Indiana tax credit based on the amount of state income taxes paid to Ohio.

**STATEMENT OF FACTS**

Taxpayer is an Indiana resident. Taxpayer is the 100 percent owner of an Ohio S-Corporation. Taxpayer receives income from the S-Corporation. Taxpayer received income from the S-Corporation during 2002. Taxpayer received a distributive share of the S-Corporation's income; taxpayer received an amount designated as wages from the S-Corporation; taxpayer received rent from the S-Corporation because taxpayer owned the building out of which the S-Corporation operated.

Taxpayer reported the S-Corporation income on an Ohio income tax return. The Department of Revenue (Department) determined that taxpayer owed Indiana income tax and sent taxpayer a notice of proposed assessment. Taxpayer disagreed with the proposed assessment and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for the protest. This Letter of Findings results.

**DISCUSSION**

**I. Ohio Income – Adjusted Gross Income Tax.**

Taxpayer maintains that he does not owe Indiana income tax because he paid Ohio income tax. Taxpayer states that he is entitled to a credit for the Ohio tax paid and that the credit is sufficient to offset any purported Indiana income tax liability.

Taxpayer received money from the Ohio company in three forms; taxpayer received a “distribution;” taxpayer received “wages;” taxpayer received rent because he owned the building out of which the S-Corporation ran its business.

“An Indiana resident must report income from all sources, including out-of-state income in calculating Indiana adjusted gross income.” 45 IAC 3.1-1-74. Therefore, on taxpayer’s 2002 Indiana income tax form, taxpayer must indicate that he received the S-Corporation distribution, wages from the S-Corporation, and rent received from the S-Corporation. If taxpayer received \$1,000 in the form of a distribution, \$500 in the form of wages, and \$200 in rent, taxpayer must report \$1,700 in income from received from the Ohio S-Corporation during that particular year.

However, Indiana has a “reciprocal” agreement with Ohio. 45 IAC 3.1-1-76 states in part that, “Residents who have income consisting of salaries, wages, and commissions from states with which Indiana has a reciprocal tax agreement must report all such income as it were from Indiana. These states include: Illinois, Michigan, Pennsylvania, Kentucky, Ohio, Wisconsin.” Under the terms of the reciprocal agreement, the Indiana resident must pay the Indiana income tax on any “wages” received from the Ohio S-Corporation. In the example cited above, taxpayer must pay Indiana income tax on the \$500. If Ohio withholds income tax on the \$500, that it is a matter to be resolved between the taxpayer and Ohio. Taxpayer may not claim an Indiana credit for any amount of income tax withheld or paid on the \$500. “Credit cannot be taken for any taxes withheld by or paid to any of these states in connection with salaries, wages, or commissions received from such states. If tax has been withheld by any of these states, a claim for refund should be filed with the state which withheld the taxes.” 45 IAC 3.1-1-76.

However, Ohio does not view the issue of wages received from an S-Corporation quite so simply. In the example cited above, taxpayer’s W-2 may state that he received \$500 in wages; Ohio disagrees interpreting that matter of wages received from an S-Corporation somewhat differently. Ohio Rev. Code Ann. § 5733.40(A)(7) states in part as follows:

For the purposes of Chapters 5733 and 5747 of the Revised Code, guaranteed payments or compensation paid to investors by a qualifying entity that is not subject to the tax imposed by section 5733.06 of the Revised Code shall be considered a distributive share of income of the qualifying entity. Division (A)(7) of this section applies only to such payments or such compensation paid to an investor who at any time during the qualifying entity's taxable year holds at least a twenty per cent direct or indirect interest in the profits or capital of the qualifying entity.

In other words, compensation or guaranteed payments made to an investor by a pass through entity – such as an S-Corporation – are considered as a distribution by the entity. Therefore, the \$500 taxpayer received from the S-Corporation is designated by Ohio as a distributive share even though the \$500 was originally labeled by the S-Corporation as “wages” on the W-2 form.

Under IC 6-3-3(a), taxpayer is entitled to claim a credit for any Ohio income tax paid on the \$500 wage/distribution. “Whenever a resident person has become liable for tax to another state upon all or any part of his income for a taxable year derived from sources without this state and subject to taxation under IC 6-3-2, the amount of tax paid by him to the other state shall be

credited against the amount of the tax payable by him.” If taxpayer has paid \$40 in Ohio income tax on the \$500 wage/distribution, taxpayer can claim a credit of \$40 on any amount of tax Indiana sees fit to impose against the same \$500.

The S-Corporation originally designated the \$500 paid taxpayer as “wages.” Ohio law says the \$500 amount is not a wage but is a “distribution” for purposes of Ohio income tax because taxpayer owns 100 percent of the S-Corporation. The Department will not quarrel with Ohio over the details of Ohio’s own tax laws. Ohio says the wages are a distribution; therefore, taxpayer is entitled to an Indiana credit against the amount of Ohio tax paid on that specific amount.

Similarly, taxpayer is entitled to claim a credit against the designated distribution received from the S-Corporation and the amount of money taxpayer received from the S-Corporation in the form of rent. In the example cited above, taxpayer received \$1,000 in the form of a designated distribution from the S-Corporation. 45 IAC 3.1-1-74 requires that taxpayer report that amount on his Indiana income tax form. However, IC 6-3-3-3(a) also allows the taxpayer to claim a credit for any Ohio income tax paid on the \$1,000. If taxpayer paid \$80 in Ohio income tax on the \$1,000 designated distribution, taxpayer can claim an \$80 credit against any amount of income tax Indiana sees fit to impose.

For the same reasons and in the same manner, taxpayer is entitled to a claim a credit for any Ohio income tax paid on the rent received from the S-Corporation.

### **FINDING**

To the extent that taxpayer is able to substantiate the amount of Ohio income taxes paid on the wages, distribution, and rent received from his S-Corporation, taxpayer’s protest is sustained.